

FX commentary
EUR/USD: Reserve balancing by Russia likely to
add downside pressure on EUR/USD

Thursday, 05 February 2009

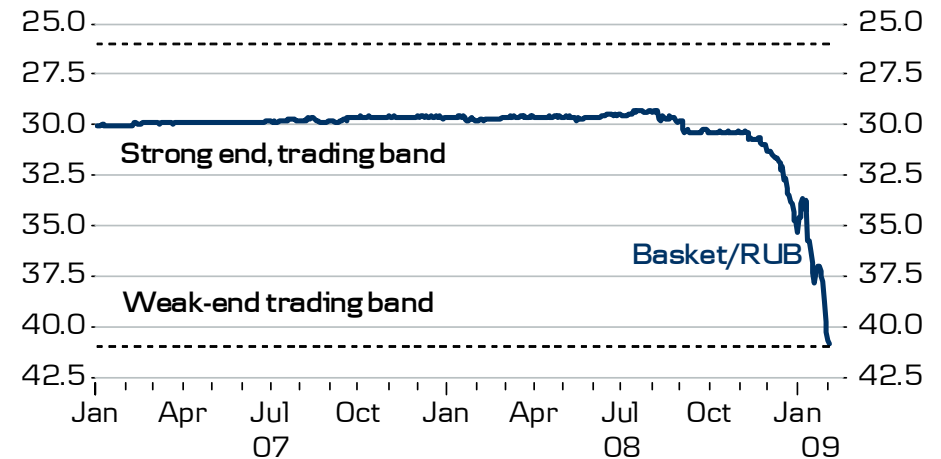
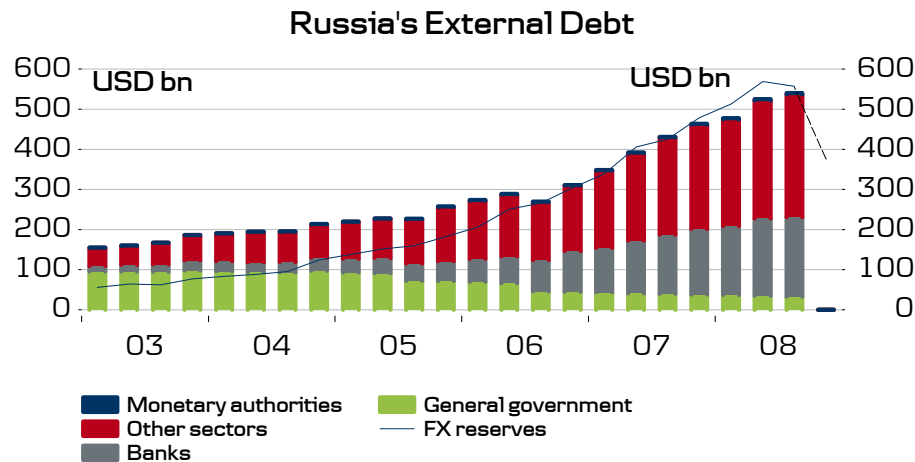
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Yet another source of euro weakness

- EUR/USD has fallen by about 10% from its Christmas high as a result of, among other things, high risk aversion, a narrowing of the EUR/USD interest rate spread, and EMU member credit downgrades. Going forward we expect EUR/USD to fall further and see reserve balancing by the Russian central bank as an important additional source of euro weakness, as:
 - The rouble is likely to come under renewed pressures in the coming days/weeks due to the current account deficit and capital outflows in the midst of negative rating actions and increased fears over external liabilities among Russian corporates.
 - The Russian central bank (CBR) will try to hold the rouble within the trading band - i.e. at basket/RUB41, at least for a couple of weeks. Hence, further intervention is likely.
 - Russian FX reserves have fallen rapidly over the past six months, from USD597bn in August 2008 to USD386bn as of the end of week 3. Our projections indicate that reserves could fall below USD370bn as of week five (corporate foreign currency debt is above USD500bn).
 - About USD50bn of the drop in reserves can be explained by the lower euro and sterling against the US dollar.
 - The remaining USD175bn has been sold to limit the depreciation of the rouble - that corresponds to USD7bn a week since August 2008.
 - **If the CBR has to intervene massively in the coming weeks - USD 5-10bn a week - then it will have to sell EUR/USD worth almost half the amount to balance its reserves. Hence the CBR is likely to sell EUR/USD worth up to USD5bn a week in the coming weeks.**

Rouble defence has been expensive



Decomposed FX-changes (valuation effect from FX movements)

	Total	EUR/USD	GBP/USD	NET FX sales/purchase
Total change since peak*, USD bn	-228.6	-37.8	-14.0	-176.7
Av. weekly change since peak, USD bn	-9.1	-1.5	-0.6	-7.1
Av. weekly change since Nov 08, USD bn	-8.9	0.2	-0.4	-9.6

* FX-reserves peaked Aug 07, 2008 at USD 597bn. We have projected FX-reserves to be USD 369bn as of week 5

Source: Reuters EcoWin

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